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No. 90-1601

In the Supreme Court of the United States

OCTOBER TERM, 1990

LILLIAN H. HALL, ET AL., PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the *D'Oench* doctrine bars petitioners' claim that a failed bank that was taken over by FSLIC had breached an undocumented agreement to overlook petitioners' failure to meet certain conditions imposed by the loan documents.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 920 F.2d 334. The opinion of the district court (Pet. App. 16a-23a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 28, 1990. A petition for rehearing was denied on January 16, 1991. Pet. App. 24a. The petition for a writ of certiorari was filed on April 15, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On August 26, 1988, the Federal Home Loan Bank Board declared Commerce Federal Savings and Loan Association, Inc. (Commerce) insolvent, and appointed the Federal Savings and Loan Insurance Corporation (FSLIC) receiver for Commerce.[1] On that same date, substantially all of the assets and liabilities of Commerce were transferred to Security Trust Federal Savings and Loan Association. However, any liability relating to the instant lawsuit was assumed by FSLIC in its corporate capacity. Pet. App. 2a-3a.

2. Among the books and records of Commerce was a term loan agreement dated January 25, 1983, together with a note, guaranty, deed of trust, and security agreement, all evidencing an agreement by Commerce to loan $1.85 million to petitioners to develop a motel in Jackson, Tennessee. The term loan agreement provided that petitioners would grant Commerce a first and prior security interest in, among other things, the furniture, fixtures, and equipment relating to the motel, including the modular units from which the motel was to be built. Pet. App. 3a-4a & n.3. The security agreement purported to grant Commerce that security interest. *Ibid.* The term loan agreement further provided that Commerce would not be obligated to fund more than $750,000 if United American Bank of Knoxville (UAB) did not participate in the loan. UAB confirmed by letter that it had committed to purchase a participation interest in the loan in the amount of $1.1 million, but UAB and Commerce

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[1] As a result of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, § 101, 103 Stat. 183, FSLIC was abolished, and its remaining assets and liabilities were transferred to the FSLIC Resolution Fund, under the management of the FDIC. The FDIC was substituted for FSLIC in this case in December 1989. Pet. App. 2a n.2.

never formally executed a participation agreement. Pet. App. 4a.

On the day that the loan closed, Commerce disbursed a first draw on the loan in the amount of $200,000. Shortly thereafter, in February 1983, Commerce notified petitioners that it would not continue to fund the loan because of petitioners' failure to grant Commerce the promised first and prior security interest in the modular motel units. Pet. App. 4a. Petitioners obtained substitute financing for the motel in October 1985. At that time they repaid (under protest) the $200,000 advance from Commerce, with interest. *Id.* at 5a.

3. Petitioners commenced this lawsuit against Commerce in April 1987. Pet. App. 2a. Petitioners claimed that Commerce's partial funding of the loan at closing constituted a waiver of the condition in the loan agreement that petitioners give Commerce a first lien on the collateral. *Id.* at 7a-8a. On May 15, 1989, the district court granted FSLIC's motion for summary judgment, finding that the doctrine of *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), applied to bar petitioners' claims of breach of contract based upon the assertion of a waiver or release not appearing in Commerce's records. Pet. App. 16a-23a.[2]

[2] *D'Oench* established a rule of estoppel that protects FDIC from a bank's misrepresentations concerning its assets and liabilities and from agreements not reflected in the bank's records. In *D'Oench*, FDIC attempted to collect on a promissory note it had acquired from a bank. The maker raised as a defense his side agreement with the bank that the note would never be called. This Court barred that defense as contrary to "a federal policy to protect [FDIC] and the public funds which it administers against misrepresentations as to the securities or other assets in the portfolios of the banks which [FDIC] insures or to which it makes loans." 315 U.S. at 457. The opinion set out the following test for application of the *D'Oench* doctrine:

> The test is whether the note was designed to deceive the creditors or the public authority, or would tend to have that effect. It would

4. A divided panel of the court of appeals affirmed. Pet. App. 1a-13a.

The court first considered petitioners' claim that *D'Oench* did not apply in instances in which FDIC had never acquired an interest in the "asset" involved in an alleged unrecorded agreement. Although the court noted that 12 U.S.C. 1823(e) does include an express "asset" requirement,[3] the court found that *D'Oench* was not "limited by the terms of § 1823(e)." Pet. App. 9a-10a (citing cases).

In particular, the court noted that there may be a number of "instances where FDIC no longer has an interest in an asset, but where the logic of *D'Oench* should still apply to protect FDIC." Pet. App. 10a. For example, an individual who owes a debt to a bank in receivership and who believes

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be sufficient in this type of case that the maker lent himself to a scheme or arrangement whereby the banking authority on which [FDIC] relied in insuring the bank was or was likely to be misled.

Id. at 460.

[3] Section 1823(e) provides:

> No agreement which tends to diminish or defeat the right, title or interest of the [FDIC] in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the [FDIC] unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

Prior to the enactment of FIRREA, § 1823(e) by its terms applied only to FDIC, not to FSLIC.

he has a claim based on an undocumented agreement with the bank might "quickly pay off the note in an attempt to block FDIC's resort to the *D'Oench* doctrine" as a defense to the individual's claim against the failed bank. *Ibid.* Similarly, FDIC may acquire loan documents from a failed bank that appear to have no value as assets, but that then become the subject of a later lawsuit in which an individual asserts a claim against the failed bank based on an undocumented agreement. The court of appeals found that in both of those cases, "*D'Oench* is important for allowing banking authorities to determine exactly what a bank's assets and liabilities are." *Ibid.* Therefore, according to the court, the *D'Oench* doctrine may be invoked "even where FDIC does not have 'an interest in an asset.'" *Ibid.*

Alternatively, the court held that on the facts of this case "*D'Oench* applies in any event, because FSLIC did have an interest in a Commerce asset"—the loan agreement itself. Pet. App. 10a. According to the court, Commerce, like petitioners, "possessed a continuing interest in the entire loan agreement after the $200,000 was repaid." *Id.* at 11a. Accordingly, "[w]hen FSLIC succeeded Commerce in its rights and duties under the loan agreement, FSLIC assumed an interest in whatever obligations remained under the loan agreement." *Ibid.*[4]

[4] In a holding not challenged by petitioners, the court unanimously held that FDIC could use *D'Oench* to defend against affirmative claims as well as to defeat the defenses of obligors. Pet. App. 11a-13a, 13a (Jones, J., dissenting on other grounds). Accord *Timberland Design, Inc.* v. *First Service Bank for Savings*, No. 90-1862 (1st Cir. May 3, 1991) (agreement to make additional loan to fund development project); *Beighley* v. *FDIC*, 868 F.2d 776 (5th Cir. 1989) (agreement to provide financing to a third party); *Bowen* v. *FDIC*, 915 F.2d 1013 (5th Cir. 1990) (promise to extend additional loan as part of debt restructuring); *FSLIC* v. *Gemini Management*, 921 F.2d 241 (9th Cir. 1990) (promise to fund entire renovation project); *FSLIC* v. *Two Rivers Associates, Inc.*, 880 F.2d 1267 (11th Cir. 1989) (agreement to fund entire development project); *Twin Construction, Inc.* v. *Boca Raton, Inc.*, 925 F.2d. 378 (11th Cir. 1991) (promise to pay construction costs).

Judge Jones dissented. Pet. App. 13a-15a. He would have held the *D'Oench* doctrine inapplicable, both because the doctrine in his view applies only when FDIC acquires an interest in an asset and because he would have held that Commerce's interest in the loan agreement was not an asset acquired by FDIC.

ARGUMENT

1. This case does not raise the question petitioners seek to present. Contrary to petitioners' assumption (see Pet. 7, 12-13, 14), the court of appeals did not simply hold that the *D'Oench* doctrine may be invoked in the absence of an asset. Rather, in a portion of the opinion neither challenged nor even mentioned by petitioners, the court expressly held that FSLIC *did* have an interest in an asset of the failed bank. Although petitioners had "paid off their $200,000 obligation before Commerce fell into receivership" (Pet. App. 10a-11a), the loan agreement at issue provided for a $1.85 million loan. As the court noted, the "obligations represented by the loan agreement were not extinguished upon repayment of the $200,000; otherwise, the plaintiffs would have no colorable breach of contract claim." *Id.* at 11a. Therefore, FSLIC acquired "an interest in whatever obligations remained under the loan agreement" and does not "lack standing to assert a *D'Oench* defense." *Ibid.*

The court of appeals thus plainly held that FSLIC acquired an asset when it acquired Commerce. That holding is sufficient to dispose of this case, regardless of how the question presented by petitioners—"[w]hether the *D'Oench* doctrine bars suit against FDIC even when no assets have been acquired by the FDIC from a failed banking institution" (Pet. i)—is answered. Therefore, the question presented by petitioners is not in fact raised by this case,

and further review of the decision of the court of appeals is unwarranted.

2. In any event, the court of appeals' discussion of the question presented by petitioners was correct and does not conflict with decisions of the Tenth Circuit in *Grubb* v. *FDIC*, 868 F.2d 1151 (1989), and of the Fifth Circuit in *Olney Savings & Loan Ass'n* v. *Trinity Banc Savings Ass'n*, 885 F.2d 266 (1989).

In *Grubb* and *Olney*, plaintiffs each sued a financial institution, asserting an affirmative claim against the institution arising out of a loan transaction. In each case, the financial institution in turn defended on the ground that the plaintiff had obligations owed to it. The respective district courts granted judgment to plaintiffs on their affirmative claims, invalidating the financial institutions' claims against plaintiffs. After the district court judgments, the financial institutions failed and were taken over by FSLIC or FDIC. *Grubb*, 868 F.2d at 1154; *Olney*, 885 F.2d at 270. The courts of appeals held that FSLIC and FDIC could not use the *D'Oench* doctrine in those circumstances to defeat the plaintiffs' claims.

In *Grubb* and *Olney*, plaintiffs obtained judgment against the failed financial institution, not FSLIC or FDIC. In the view of the *Grubb* court, the *D'Oench* rule therefore could not be invoked to reverse district court judgments valid when entered against now-failed financial institutions. See 868 F.2d at 1159. Cf. *Olney*, 885 F.2d at 275 (rejecting argument that recent statutory change permitted "conservators to raise [12 U.S.C. 1823(e) claims] on appeal for the first time, after the entry of a final judgment to which they were not a party").

In addition, the *Grubb* court concluded that the judgment voiding the assets and determining the affirmative claims in the case before it provided a "reliable record" both

of the value of the assets (zero) and the institution's liability at the time of FSLIC or FDIC takeover. 868 F.2d at 1159. Or, as the *Olney* court reasoned, "because a final judgment existed when FSLIC entered as conservator, the purposes of *D'Oench* * * * [would] not be impaired" if the judgment were left intact. 885 F.2d at 275. In both cases, entry of the district court judgment prior to the bank's failure was viewed as eliminating a predicate for application of the *D'Oench* doctrine—an agreement not reflected in official records or books available to federal banking authorities.

Unlike *Grubb* and *Olney*, this case presents a core application of the *D'Oench* doctrine. First, even if correct, the decisions in *Grubb* and *Olney* would only preclude FSLIC or FDIC from invoking *D'Oench* to obtain appellate reversal of a district court judgment valid when entered. In this case, however, petitioners instituted suit against FSLIC after Commerce had failed. *Grubb* and *Olney* therefore would not stand in the way of FSLIC's invocation of *D'Oench* in the district court in this case. Second, at the time FSLIC acquired Commerce, there was no judgment or other "reliable record" of Commerce's alleged waiver of petitioners' obligation under the loan agreement to convey to Commerce a prior security interest to the modular motel units. Lifting the *D'Oench* bar in this case would thus frustrate one of the "two main purposes" of *D'Oench*—to "permit[] federal and state banking examiners to rely on a bank's records in evaluating the fiscal soundness of the institution." *Grubb*, 868 F.2d at 1158. Cf. *FDIC* v. *McCullough*, 911 F.2d 593, 600 (11th Cir. 1990) (noting that the "evil to be prevented" by *D'Oench* is an attempt by the private party "to rely upon unrecorded promises or schemes that purport to impose obligations other than those appearing in the bank's records upon the financial institution").

Because *Grubb* and *Olney* raised fundamentally different issues concerning the application of the *D'Oench* doctrine

than does this case, the decisions in those cases do not conflict with the decision reached by the Sixth Circuit here. Further review is therefore unwarranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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